TAXATION OF CHARITABLE AND RELIGIOUS TRUSTS
PRACTICAL ISSUES AND RECENT DEVELOPMENTS

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Application of Income

85% of current year's income must be applied

- Application from loan, corpus donation and income accumulated from earlier years are not allowed as deduction. Trust can neither claim loss nor any loss can be carried forward
- Application shall be subject to disallowances specified u/s 40(a)(ia) and 40A(3)
- Application shall be computed on cash basis. (i.e., opening balance of creditors can be added to application and closing balance of creditors shall be reduced from application)

What if 85% of current year income is not applied?

- Amount to the extent of 15% can be unconditionally accumulated
- The surplus beyond that shall become taxable at applicable rates.
- Surplus can be accumulated vide explanation to Section 11(1) – Form 9A – e-file – state reasons for accumulation – time limit as per the Act is 2 months prior to 139(1) due date – Circular 6/2023 restored it back to 139(1) due date
- Surplus can be accumulated up to 5 years u/s 11(2) – E-File Form 10 stating the purpose of accumulation - time limit as per the Act is 2 months prior to 139(1) due date – Circular 6/2023 restored it back to 139(1) due date – Accumulated funds shall be invested as specified in Section 11(5)
- For condonation of delay in filing Forms 10 or 9A – refer circular 17/2022
- ITR 7 vis-à-vis Form 10 – Year wise disclosure table – ITR asks to fill up data financial year wise – Form 10 just asks for year wise data – Is AY or FY meant in Form 10?

Application out of corpus donation / loan

- Amount applied using corpus donation or loan funds is not allowed as deduction
- If amount once applied from corpus donation is subsequently replenished using current year income, the amount replenished can be claimed as deduction.
- Similarly if loan taken is repaid using current year income, the repayment can be claimed as deduction
- Replenishment of corpus / repayment of loan are subject to restrictions:
  - If amount spent prior to 01.04.2021 is replenished or repaid, no deduction will be allowed, even when the amount spent was disallowed in the relevant year.
  - If replenishment or repayment is after a period of 5 years from the year of spending, no deduction will be allowed. (if loan period is 25 years, deduction will be allowable only for first 5 years)
- Un applied corpus donation shall be invested as specified u/s 11(5)

Deduction in respect of depreciation (Section 11(6))

- When cost of asset acquired is claimed as deduction, depreciation thereon cannot be claimed.
- In respect of asset acquired out of loan or corpus donation, cost cannot be claimed as deduction. Also there are restrictions regarding claiming deduction in respect of loan repaid / corpus replenished. Therefore, why not claim depreciation on the asset.
- Similar is the case with asset acquired out of corpus donation
- Depreciation is not on the block of assets at Section 32 rate. It shall be SLM as per the accounting principles.
- It may also be noted that depreciation is to be deducted from income and not added to application.

Donation by one trust to another

- Deduction available to the donor trust will be limited to 85% of the amount donated
- CBDT circular 3/2024

Representations have been received by the Central Board of Direct Taxes (CBDT) raising concerns as to whether the balance 15% of donation to other trust / institution would be taxable or would be eligible for 15% accumulation, since the funds would not be available, having been already disbursed.

CBDT has examined the matter with reference to the issues raised above. Vide Circular No. 3/2024 in F.No.370142/5/2024-TPL dated 06.03.2024, issued today, the matter has been clarified by illustrative examples, for lucid understanding. The said Circular is available on circular-3-2024.pdf (incometaxindia.gov.in).

CBDT circular 3/2024

4. The matter has been examined with reference to the issues raised in paragraph 3 and it is reiterated that eligible donations made by a trust / institution to another trust / institution under any of the two regimes referred to in para 2 shall be treated as application for charitable or religious purposes only to the extent of 85% of such donations. It means that when a trust / institution in either regime donates Rs. 100 to another trust / institution in either regime, it will be considered to have applied 85% (Rs. 85) for the purpose of charitable or religious activity. It is clarified that 15% (Rs. 15) of such donations by the donor trust / institution shall not be required to be invested in specified modes under section 11(5) of the Act as the entire amount of Rs. 100 has been donated to the other trust / institution and is accordingly eligible for exemption under the first or second regime.

CBDT circular 3/2024

This is illustrated by following example where Trust1, Trust2 and Trust3 are trusts or institutions under any of the two regimes. Further, Trust1 is making eligible donation to Trust2 and Trust2 is further making eligible donation to Trust3.

Sl. No.	Particulars	Trust1		Trust2		Trust3	
1.	Income (A)	300		100		100	
2.	Income which is required to be applied (B = 85% of A)		255		85		85
3.	**Application of income**						
4.	Donation to other trusts under the first or second regime (C)	100		100			Nil
5.	Amount to be considered as application of income against the donations at row no. 3 [as per clause (iii) of the Explanation 2 to third proviso to clause (23C) of section 10 or clause (iii) of the Explanation 4 to sub-section (1) of section 11 of the Act]. (D = 85% of C)		85		85		
6.	Balance income for application (E = A – C)	200		Nil		100	
7.	Application other than Sl. No. 4 (F = 85% of E)		170		Nil		85
8.	Remaining income which may be accumulated without Form No. 10 / 9A (G = 15% of E)		30		Nil		15
9.	Funds required to be invested in section 11(5) modes (H = G)		30		Nil		15
10.	Exemption of income (I = C + F + G)	300		100		100	

Filing of audit report, ITR and filing u/s 80G

Filing of audit report (Refer ICAI GN issued in July 2024)

- Form No. 10B
  - Gross receipts > Rs. 5 crores or
  - Receipt of FC or
  - Application of income outside India
- Form No. 10BB
  - In any other case where audit is warranted u/s 12A
- In the case of small trusts, not in receipt of foreign money and not having foreign spending, with gross receipts less than basic exemption, audit is not required and hence Form 10B / 10BB is also not required.
- Audit report has to be e-filed one month prior to 139(1) due date. Belated audit report can result in disallowance of income applied. Twice extended in AY 2023-24 (a) up to 31.10.2023 (Circular 16/2023) and (b) up to 31.03.2024 (Circular 2/2024). AY: 2023-24 – 10B filed in place of 10BB or vice versa – condonation extended till 10.11.2024 (Order dated 07.10.2024). Condonation requests shall be liberally viewed – Kerala HC – Mary Queens Hospital and others – WPC 17059/2024
- For condonation of delay in filing audit report – refer Circulars 15/2022 & 16/2022.
- Books to be maintained as mentioned in Rule 17AA
- FRN of auditor – it asks for 1 more digit – eg FRN 060014S type as 0060014S

Filing of ITR

- Exemption can be claimed in both the cases
  - Return u/s 139(1)
  - Belated return u/s 139(4)
  - This year ITR due date extended till 15.11.2024 – therefore 10B/10BB due date Oct 15?
- Exemption cannot be claimed in an updated return
- Order of uploading of forms shall be
  - Step 1 – Forms 10 / 9 A
  - Step 2 – Form 10B or 10BB
  - Step 3 – Forms 3CA/3CB and 3CD, if applicable
  - Step 4 – ITR 7
- New ITR 7 asks for acknowledgment number of Form 10B/10BB and UDIN of Form 10B/10BB
- All tasks by assessee can be managed using Aadhaar OTP
- Savings bank account – can it be shown as ‘others’

Filing u/s 80G

- Form 10 BD – List of donors – Due date May 31
- Form 10 BE – Donation receipt generated from the portal – Due date May 31
- Late fee – Rs. 200 per day – Section 234G
- Penalty – Rs. 10,000 to Rs. 1,00,000 – Section 271 K
- Form 10BD once filed on time can be revised subsequently without any late fee

Related party transactions & Specified Violations

Related party transactions

- Beneficiaries are meant to be public. Hence, if benefits are conferred by the trust to specified related parties, penal consequences follow
- Reporting in audit report
- Tax u/s 115BBI
- Penalty u/s 271AAE – 100% first time 200% subsequently
- Can lead to cancellation of registration

FA: 2022 – Computation of taxable income resulting on account of certain prescribed non-compliances AY 2023 – 24 onwards (S – 13(10))

•Currently, there is no explicit provision determining the manner of computation of taxable income resulting on account of non-compliances. **Presently officers tax the gross receipts without allowing application of income.**

•Now, it is provided that the taxable income resulting on account of prescribed non-compliances (such as (a) **not maintaining prescribed books** of accounts, (b) **not filing the TAR/ITR**, and (c)**carrying on commercial activities for consideration** beyond the prescribed threshold of 20%) shall be computed **after allowing deduction of revenue expenditure** incurred in India, but subject to the following conditions:

•Expenditure should not be a donation or contribution to any person.

•Expenditure incurred without withholding appropriate tax or expenditure incurred in cash beyond the prescribed threshold shall not be allowed.

•Expenditure incurred from the corpus or any loan or borrowing shall not be allowed.

•Depreciation on an asset, the cost of which is claimed as application of income in any year, shall not be allowed.

FA: 2022 – New tax rate prescribed for certain specified income – 115BBI

•Currently, there is an ambiguity on the tax rate that applies, where certain specified income of the trust/ institution become taxable.

•Now, it is provided that **specified income (resulting from violations such as (i) accumulation of funds for prohibited purposes, (ii) partial application of accumulated funds, (iii) deployment of funds in prohibited investments, and (iv) diversion of income/provision of excessive benefits to trustees/other specified persons)** would be taxable at a **flat rate of 30 percent (plus applicable surcharge if any and cess)** without reduction of any expenditure or allowances or set off of losses.

•Other incomes (if any) of the trust/institution will be taxable per the currently applicable provisions – **Notification dated 31.10.2023 – ITR 7 amended – line item added**

FA: 2022 – Proportionate income (instead of entire income) now made taxable on account of prescribed non- compliance

- It is provided that if trust/institution **diverts income/ provides excessive benefits to trustees/other specified persons or deploys its funds in prohibited investments only that part of income** that is diverted/regarded as excessive benefit/deployed in prohibited investments **would be taxable**. (items iii & iv) in the previous slide

- This position has been upheld in certain rulings even before the amendment. As discussed above, such income will be taxable at a flat rate of 30 percent without any deductions.

Conclusion

Creating a trust, ensuring compliance and closing down a trust, all require lots of our professional time, effort and stress. Don't forget that we are not charitable institutions. So bill adequately.

THANK YOU